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Essential pensions news

Updater

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Introduction

Essential pensions news covers the latest pensions developments each month.

Gender pay gap – new regulations come into force

Of interest to all employers with more than 250 employees are the Equality Act 2010 (Gender Pay Gap Information) Regulations 2017 (the Regulations), which came into force on *April 6, 2017*. Large private and voluntary sector employers (defined as those with 250 or more employees on April 5 of each year) will be required to analyse the 'gender pay gap' in bonuses and ordinary pay each April, and publish a report no later than *April 4, 2018*, and annually thereafter.

The value of any salary sacrifice is excluded from the definition of 'ordinary pay' under the Regulations, and the definition also appears not to include employer pension contributions.

ACAS and the Government Equalities Office have published joint guidance and various guides and templates for affected employers.

An overview of the reporting requirements

The Regulations apply to large private and voluntary sector employers, who must publish

- Overall gender pay gap figures for relevant employees, calculated using both the mean and median average hourly pay.
- The proportion of men and women in each of four pay bands (quartiles), based on the employer's overall pay range. This will show how the gender pay gap differs across the organisation, at different levels of seniority.

- Information on the employer's gender bonus gap (that is, the difference between men and women's mean and median bonus pay over a 12-month period).
- The proportion of male and female employees who received a bonus in the same 12-month period.

Employers will have the option to include a narrative explaining any pay gaps or other disparities, and setting out any action they plan to take to address them. However, the provision of a narrative will not be mandatory.

What counts as 'ordinary pay'?

'Ordinary pay' is defined as basic pay, bonuses, allowances, pay for piecework, pay for leave and shift premiums. It excludes overtime pay, expenses, benefits in kind and 'remuneration provided otherwise than in money'.

Publication of the annual report

Affected employers must analyse their gender pay gap each April, publish their report within 12 months; and annually thereafter. The report must be published on the employer's website and it must be kept online and publicly available for at least three years. They must also upload the information to a designated Government website.

Salary sacrifice and benefits in kind

Surprisingly, the value of salary sacrifice schemes has been excluded from the definition of ordinary pay, which may have a distorting effect on an organisation's gender pay gap. It is possible that employers could implement or increase salary sacrifice arrangements to artificially reduce high earners' income for the purposes of the reporting requirements, meaning substantial portion of income would be disregarded for the purposes of calculating the gender pay gap.

As for the exclusion of benefits in kind, this may make the calculation of the gender pay gap more straightforward because employers can simply disregard the benefits altogether, rather than attribute a value to them.

Pension contributions

Although not expressly stated in the Regulations, it appears that employer's pension contributions are intended to be excluded from the definition of ordinary pay. Employer's pension contributions would not normally be regarded as 'basic pay' and do not fit into any of the other definition categories. The calculation of the hourly rate of pay under regulation six takes into account only ordinary pay and bonus pay 'paid to the employee', and it is difficult to see how a payment made by an employer directly into a pension scheme could be regarded as paid to the employee.

As regards an employee's pension contributions, the ACAS guidance states that the employee's pay and bonuses must be calculated *before* any pension deductions. However, where pension contributions are made by way of salary sacrifice, this changes the position because payments made via such arrangements are excluded from the calculations, which seems inconsistent.

Employers' preparation for the new regime

There are several steps that employers should consider to prepare for the new regime, including

- Identify whether the employer is a relevant employer for the purposes of the Regulations.
- For corporate groups, consider which employing entities will be relevant employers for the purposes of the Regulations, and identify how many separate gender pay gap reports will need to be produced.
- Identify any areas of uncertainty over who is in scope. For example, where there is a large pool of casual workers or contractors, how will they be treated?
- Consider the status of any employees based overseas who are employed by a UK entity.
- Consider the remuneration package offered, all benefits, and any flexible benefits scheme, and analyse which elements would be reportable under the Regulations.

For further information, please contact your usual Norton Rose Fulbright adviser and see our webcast and transcript on 'Addressing the gender pay gap'.

Pensions Regulator consults on monetary penalties policy and revised description of professional trustee

The Pensions Regulator (TPR) is consulting on a draft policy for monetary penalties together with a revised description of what it considers to be a 'professional trustee'.

The consultation was published on *March 23, 2017* and forms part of its 21st century trustee initiative under which it has stated that it intends to make greater use of its power to impose monetary penalties where there have been wider scheme governance and administration failings.

The draft monetary penalties policy contains a proposed penalty framework which will guide TPR in determining the amount of the penalty. The framework consists of three penalty bands of increasing severity with the nature and impact (or potential impact) of a breach determining in which band the breach falls. Each band level has a suggested range of penalty depending on whether the person is an individual trustee or not (the middle of each band range for non-individuals being ten times higher than that for individuals).

TPR is also consulting on a revised description of 'professional trustee', which is important since TPR has stated that penalties for professional trustees will generally be higher than for other trustees. Its current approach is to consider those who charge for their services to be professional trustees, but some have commented that remuneration is not necessarily determinative due to the increased practice of paying trustees who do not provide commercial trustee services.

The proposed revised description focuses on whether a trustee is acting in the course of the business of being a trustee. TPR will consider a person to be a professional trustee where they act as a trustee of the scheme in the course of the business of being a trustee or where they are an expert, or hold themselves out as an expert, in trustee matters generally.

TPR states that it will review its approach to penalties relating to master trusts after the Pension Schemes Bill 2017 has completed its passage through Parliament.

The closing date for responses is *May 9, 2017*.

View the draft Policy.

TPR issues guidance on setting and monitoring DB investment strategies

Of interest to all DB schemes is the new guidance for trustees published by TPR on *March 30, 2017*. The guidance sets out practical information and examples of approaches trustees could take and factors to consider when investing scheme assets to fund defined benefits.

The guidance has been issued as part of TPR's strategy to produce simpler guidance for occupational pension schemes, and includes sections on

- **DB investment governance** – this section includes the trustee board's role in investment governance, working with investment advisers and preparing the statement of investment principles.
- **Investing to fund DB** – including guidance on setting an appropriate investment strategy (which TPR considers to be a key part of an integrated risk management approach), understanding investment risks and using models to help in setting the investment strategy.
- **Matching DB assets** – using matching assets, understanding the risks of matching assets and the requirement for scheme assets to be properly diversified.
- **DB growth assets** – understanding growth assets, the risks involved and putting in place appropriate methods to manage those risks.
- **Implementing a DB investment strategy** and understanding and managing the associated risks.
- **Monitoring DB investments** – identifying and communicating the information required to monitor the scheme's investments and its funding level effectively.

We will be publishing a full briefing on TPR's new guidance shortly.

View the guidance.

TPR updates its detailed auto-enrolment guidance notes

Of interest to all schemes are the updates made by TPR to its detailed online auto-enrolment guidance notes. Changes have been made to several notes to reflect developments such as the new qualifying earnings thresholds for 2017/18 and the expansion of the statutory exceptions to include the latest forms of tax protection.

Guidance note 3b (Transitional period for schemes with defined benefits) has been considerably expanded, with the new material detailing the steps that will be required later in the year by employers who chose to take advantage of the transitional period for DB and hybrid schemes, which runs until *September 30, 2017*, a key point being on the use of postponement at the end of the transitional period.

TPR highlights the interaction between the three-month postponement period and the six-week joining window and notes that even where postponement is used, the auto-enrolment process for any eligible jobholders must be completed by *November 11, 2017*.

Among other changes, guidance note four (Pension schemes) has been updated with new content concerning the forthcoming increase in mandatory minimum contributions to DC schemes taking effect in *April 2018*. The new material provides a summary of the relevant considerations for employers, including whether formal rule amendments and consultation with affected employees are required. (Paragraphs 125-166.)

The latest update to guidance note two (Getting ready) is pending and will be published shortly.

View the detailed guidance.

PPF publishes policy statement on levy rule for schemes without a substantive sponsor and final levy determination 2017/18

Of interest to all DB schemes is the publication on *March 30, 2017* of the PPF's final levy rules for the 2017/18 levy year together with a policy statement on the levy rule for schemes without a substantive sponsor (Policy Statement).

The Policy Statement follows a consultation on which we reported in February 2017 on how the PPF would charge a levy to schemes that have no substantive employer. Following that consultation, the PPF has concluded that there is no clear case for adjusting its proposals and it will therefore apply them, as set out in the February consultation paper, for the 2017/18 levy year. Given the limited time stakeholders have had to consider the proposals, the PPF has committed to consult further on the methodology before finalising rules for the 2018/19 levy year.

The Policy Statement sets out the key themes raised in the consultation responses. In particular, the PPF confirms that it does not currently intend to include existing arrangements (those entered into before *January 1, 2017*) within the scope of these rules, although it does not rule out extending the methodology to existing schemes in the future if considered appropriate.

The Policy Statement also provides further explanation of the schemes to which the rule will apply. Broadly, the rule will only apply where the scheme has separated from its previous substantive employer or the employer has suffered an insolvency event, the scheme is running on and is seeking to pay scheme benefits, purely from scheme assets and the scheme has entered into an ongoing governance arrangement. The PPF also provides worked examples of levy charges to help schemes understand the impact of the new methodology.

In relation to the final levy rules, a small number of drafting changes have been made since they were first published in December 2016. The amendments, which are mainly clarifications, are detailed in section eight of the Policy Statement.

The relevant publications, including the Policy Statement, are available here.

PPF publishes consultation on rules for the next triennium

The Pension Protection Fund (PPF) has started a consultation exercise on the future of its levy policy in the three years from the 2018/19 levy period. This consultation focusses primarily on changes to the way insolvency risk is assessed, but also covers a range of other areas including

- **Changes to the current scorecard system:** the PPF states that the current model has 'performed well' but that certain aspects need improvement. For example, while the actual insolvency rate amongst PPF-universe employers has fallen in the last three years, the predicted insolvency rate across all employers (particularly for the large and complex scorecard) has dropped significantly further, suggesting a need to 'recalibrate the scorecards'. In particular, the 'not for profit' scorecard has not generated a level of predicted insolvencies that is consistent with actual experience.

- **Alternative approaches to assessing insolvency risk:** the consultation highlights where the current single methodology for insolvency risk might be substituted for different methods for some of the largest schemes, schemes with employers who have a 'proximity to the Government' and those without a substantive employer. Views are also sought on whether elements of the levy system are 'particularly problematic' for small schemes and the 'appetite for simplification'.

- **Discounted levy for good scheme governance:** the PPF seeks views on whether there is a case for allowing a reduction in a scheme's levy bill to reflect good governance (a proposal it considered and rejected in 2011).

- **Changing risk-reduction certification:** in reaction to industry feedback the PPF is consulting on

  — The treatment of certain scheme costs that currently must be set against cash paid into a scheme before a deficit reduction contribution is certified.

  — Requiring that a guarantor strength report must be prepared in advance certification of a 'very high value' Type A contingent asset. The report must demonstrate that the guarantor would be able to meet the terms of the guarantee in the event of employer insolvency.

  — A review of standard form contingent asset agreements. There has been a suggestion that an ambiguity exists in the wording relating to capped guarantees. Although the PPF does not believe such ambiguity exists comments are invited on the current wording in the standard form agreement. If the PPF ultimately decides that the current standard form contingent asset agreements need to be updated, then existing agreements may have to be amended and re-executed.

  — Making it easier for guarantor-employers to have a guarantee taken into account and to make certification easier for multiple guarantors.

The consultation closes on *May 15, 2017*.

A second consultation will follow in 'Autumn 2017'. This will set out the PPF's conclusions, with definite proposals on these issues, as well as including the draft 2018/19 levy determination.

PPF publishes updated guidance

The PPF has published the following updated online guidance

- Section 152 guidance – version D3
- Section 143 guidance – version H6
- Section 179 guidance – version G7
- Section 156 guidance – version C3
- Additional information for carrying out a section 143 valuation.

View the amended guidance.

Public launch date announced for pensions dashboard prototype

Of general interest is the recent progress on the development of the cross-industry pensions dashboard project. The Government announced its plans for the project at the March 2016 Budget. The intention is to set up by 2019 an online service that will allow individuals to see all their pension savings in one place.

Last December, the Association of British Insurers (ABI) announced the identity of the six 'FinTech' firms that were chosen as technology development partners on the project. The ABI-led project group is reporting regularly to HM Treasury and working with the wider industry, Government, regulators and trade bodies in developing a prototype pensions dashboard.

The prototype has now been delivered and demonstrated to Government ministers, the objective being for the service to be up and running by *2019* and for it to be offered by a range of different providers rather than by a single, central service.

The ABI commented: "It sounds obvious that in 2017 everyone should have easy online access to all their pension information in one single place of their choice – yet the practicalities of making that happen are very complex. The prototype demonstrates once and for all that the technological hurdles can be overcome." The prototype was due to be demonstrated to the public on April 12, 2017 during Britain's FinTech week.

We understand that the ABI has also asked the Government to legislate so that every pension scheme in the UK will compulsorily enter member information into the pensions dashboard and for the Financial Conduct Authority (FCA) to act as its regulator, rather than TPR. This, the ABI says, would be a logical approach ensuring continuity, given that some of the types of firms that would offer dashboards are already regulated by the FCA.

HMRC publishes issue no. 24 of its countdown bulletin

On March 27, 2017, HMRC published the latest edition of its countdown bulletin for formerly contracted-out DB schemes.

The contents are outlined below

- A reminder that the deadline for completing all reconciliation activity is *December 2018*, and that there will be no facility to raise queries with HMRC after *October 2018*.
- Where schemes have sent HMRC queries using the Scheme Reconciliation Service (SRS), HMRC will assume that such queries are answered satisfactorily where no further queries are submitted within six months of HMRC's initial response.
- An update on the automation of SRS queries, and information which is required for use of the automated service, together with tips on how to make the most of the service.
- HMRC has produced a spreadsheet of all articles which have been published in Countdown Bulletins, and the issue in which they appear. An email address is provided for those who wish to receive a copy of the spreadsheet, or articles about a particular topic.
- Details of the Contracted-out Pensions helpline for general enquiries.

View the Countdown bulletin.

Finance bill 2017 published

On *March 20, 2017*, the Government published the first version of the Finance Bill 2017, along with explanatory notes and draft HMRC guidance. The Bill includes measures announced at the 2016 Autumn Statement and the Spring 2017 Budget, and a summary of the provisions relating to occupational and personal pensions, and an outline of the Government's response to its consultation on reducing the money purchase annual allowance (MPAA), are provided below.

- **Reduction of the MPAA from £10,000 to £4,000**: it was confirmed in the Spring 2017 Budget that, following a consultation, the Government was going ahead with plans announced at the 2016 Autumn Statement to reduce the MPAA with effect from *April 6, 2017*. The key points to note in the Government's response to the consultation on this issue are
  - That the £4,000 MPAA applies from *April 6, 2017* to anyone who has accessed benefits flexibly, regardless of when they made the decision to access that pension. There will be no protection or transitional arrangements for those who flexibly accessed benefits when the MPAA was £10,000.
  - A suggestion by respondents to the consultation that the right to an MPAA of £10,000 for those who accessed benefits flexibly before the date on which the MPAA consultation was launched was dismissed by the Government as 'disproportionately complex' as the likely number of affected individuals was small.

- A suggestion that the MPAA should apply only to personal contributions, as that employer contributions could not constitute recycling of pension savings, was rejected. The Government's view was that employers often allow employees to salary sacrifice for an employer pension contribution, which is in effect, indirect recycling.

- Suggestions that recycling could be controlled through an alternative mechanism were rejected as the Government considers that a lower MPAA is simpler and more appropriate.

- The Government considered that the reduced MPAA would have little impact on the roll-out of automatic enrolment, even when contributions have risen to eight per cent. The MPAA level would be kept under review to ensure that it does not impact on the future development of automatic enrolment.

- Some respondents argued that there was an inequality between individuals who access their DC benefits flexibly and individuals who access DB entitlements, who do not become subject to the MPAA. In response, the government stated that accessing DB entitlements was not flexible access and that it has no intention to extend the application of the MPAA to circumstances other than when savings have been flexibly accessed. DB accrual will remain subject to the alternative annual allowance, not the MPAA, when DC savings have been flexibly accessed.

- **Tax on transfers of pension savings to qualifying recognised overseas pension scheme** (QROPS): a new 'overseas transfer charge' applies to transfers requested on or after *March 9, 2017*. The member and the scheme manager of a transferring QROPS will be jointly and severally liable for the charge (see further below).

  Guidance in relation to the overseas transfer charge has been included in edition 85 of HMRC's pension schemes newsletter;

- **Exemption from income tax on employer-arranged pensions advice**: from *April 6, 2017*, the first £500 of pensions advice provided to an employee, former employee or prospective employee in any tax year will be tax free. This clause replaces existing provisions which limit the exemption solely to pensions advice and was capped at £150 for each employee in any tax year.

  The exemption applies where 'relevant pensions advice' is provided by an employer or where the employer pays for or reimburses the cost of advice incurred by an employee, a former employee or prospective employee in obtaining relevant pensions advice.

  'Relevant pensions advice' covers information or advice in connection with a person's pension arrangements as well as advice on the use of the person's pension funds.

  For the exemption to apply, the pensions advice, payment or reimbursement must be provided under a scheme that is open to employees generally or open to employees at a particular location. An employer may provide advice to certain groups of employees where they have reached the 'minimum qualifying age' under the employer's scheme or meet the ill-health condition, provided the advice is available to all employees in the same situation. The 'minimum qualifying age' is broadly the employee's normal minimum pension age, less five years.

  The exemption applies at employment level. If an individual has more than one employment and his employers provide pension advice in the relevant tax year, the exemption can apply to each employment.

The Government has confirmed that it will be possible to combine this tax exemption with the new pensions advice allowance authorised payment to enable individuals to access up to £1,000 of tax advantaged financial advice and that the use of one exemption does not prevent an individual from accessing the other.

The Registered Pension Schemes (Authorised Payments) (Amendment) Regulations 2017 introducing the new authorised payment in the form of the pension advice allowance payment, have now been made and came into force on *April 6, 2017*.

Pension schemes bill 2016/17 update

The Pension Schemes Bill was considered at report stage in the House of Commons on *March 29, 2017* and had its third reading.

There were several proposed amendments, including one re-introducing the 'scheme funder of last resort' clause in the event that a master trust fails. This clause was initially introduced in the House of Lords at report stage but subsequently removed during committee stage. The Government considered that the measure was 'disproportionate to the problem' and that the new regulatory regime for master trusts provides sufficient protection to make it unnecessary. The amendment was rejected.

In addition, an amendment requiring master trusts to provide for at least a third of trustees to be member-nominated was rejected. The Government considered that master trusts were already subject to rules concerning the appointment of trustees and that the new clause was unnecessary.

A proposed amendment concerning the application of section 75 of the Pensions Act 1995 to unincorporated businesses in non-associated multi-employer schemes (specifically to deal with issues currently facing plumbers in the industry-wide plumbers pension scheme) was withdrawn. The Government commented that these issues were raised in its recent Green Paper (on major changes to DB benefit provision) and that a round table of representatives from the relevant schemes are looking at what changes might be required.

The Bill returned to the Lords on *April 5, 2017*, for consideration of amendments made by the House of Commons. Concerns were raised about the use of the affirmative resolution power to make regulations under the Bill to provide for exceptions from the requirement that an organisation may only carry out activities that relate directly to master trusts in relation to which it is a scheme funder. Exceptions to this requirement would allow a scheme funder to carry out activities in relation to more than one master trust, if it is a scheme funder or prospective scheme funder of each.

Addressing these concerns, Lord Henley, Under Secretary of State at the DWP, commented that, given the wide variety of master trust scheme structures and arrangements, the DWP will work closely with 'key stakeholders', as part of its ongoing consultation to develop the first set of regulations. He added that the Government expects subsequent amendments to those regulations to be 'relatively minor'.

The Bill now moves to the Royal Assent stage, although a date has yet to be set.

DWP consults on draft regulations relating to transfers with member consent of contracted-out pensions in payment

On April 10, 2017, the DWP published for consultation the draft Contracting-out (Transfer and Transfer Payment) (Amendment) Regulations 2017. The consultation period is extremely short, ending on *April 23, 2017*.

The draft regulations will amend the circumstances in which contracted-out pensions in payment may be transferred with member consent.

The easement will apply in limited circumstances, and will permit transfers to occupational pension schemes that were never contracted-out of guaranteed minimum pensions (GMPs) in payment or pensions deriving from section nine (2B) rights where the transferring scheme has gone into a PPF assessment period or a regulated apportionment arrangement has been entered into in relation to it.

Further conditions also apply

- The receiving scheme must be an occupational pension scheme which is not an overseas scheme or overseas arrangement.
- The member must consent to the transfer in writing.
- The member must acknowledge in writing to the transferring scheme the receipt of a statement showing the benefits to be awarded in respect of the transfer.
- The member must accept in writing that the benefits to be provided by the receiving scheme may be in a different form and of a different amount to those which would have been payable by the transferring scheme, and that there is no statutory requirement on the receiving scheme to provide any survivor's benefits out of the transfer payment.

The DWP states in the consultation that the change is being made in response to calls for urgent action to close an 'anomaly' in the existing legislation whereby with-consent transfers from formerly contracted-out schemes to newly established schemes are permitted in relation to deferred members, but not in relation to pensioner members. These transfers are often sought as part of restructuring arrangements undertaken where employers and schemes are in financial difficulty, as a means of avoiding entering the PPF.

The DWP explains that additional legislative changes permitting bulk transfers without member consent to schemes that were never contracted-out are still being actively considered, together with an extension of the circumstances in which with-consent transfers of pensioner members are permitted. The Government intends to act in relation to without-consent bulk transfers later in the near future and it will also consider extending the circumstances in which with-consent transfers of pensioner member are permitted.

Comment

Although the draft regulations are fairly narrow in scope, they have been welcomed as they will mean pensioner members of distressed schemes have a chance to receive better benefits than they would in the PPF.

Following the introduction of the new State Pension in *April 2016*, salary-related contracted-out schemes can no longer transfer pensioner members to newly created schemes (with their consent) because these transfers can currently only take place to schemes that have been formerly contracted-out.

With the recent publication of the Government's Green Paper 'Security and Sustainability in Defined Benefit Pension Schemes', the Government made it clear that it wants to support the sustainability of DB schemes whilst protecting members' benefits. It is aware that the anomaly in the current contracting-out legislation means that whilst deferred members can benefit from better pension arrangements through a transfer, pensioner members cannot.

The DWP has expedited changes to the legislation, with BHS pensioners likely to be among the first to benefit. Hopefully, the DWP will apply the extension of the newly drafted regulations before too much longer to schemes which are not in financial difficulty.

The rules governing transfers of contracted-out rights generally require overhauling, and it seems the DWP has now acknowledged this.

View the draft regulations.

Regulatory requirements test amended for overseas pension schemes – new regulations

The Pension Schemes (Categories of Country and Requirements for Overseas Pension Schemes and Recognised Overseas Pension Schemes) (Amendments) Regulations 2017 amend the requirements that a scheme must meet to be an 'overseas pension scheme' for the purposes of the Finance Act 2004 from *April 6, 2017*.

The requirements a scheme must meet to be an overseas pension scheme are amended to

- Remove the so-called 70 per cent rule under which scheme rules must provide for 70 per cent of UK-tax relieved funds to be used to provide the member with an income for life.
- Allow schemes to pay benefits earlier than normal minimum pension age if it would be an authorised payment if paid by a registered pension scheme.
- Require the provider of a non-occupational pension scheme to be regulated in the country where the scheme is established if the scheme itself is not regulated.

DWP publishes draft occupational pension schemes (Charges and Governance) (Amendment) Regulations 2017 – cap on early exit charges and prohibition on member-borne commission

Of interest to all schemes is the DWP's consultation on the draft Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2017.

The Regulations introduce restrictions on early exit charges for members of occupational pension schemes who are eligible to access the pension flexibilities.

The Regulations also prevent member-borne charges being imposed in occupational schemes used for auto-enrolment to cover contracts entered into before *April 6, 2016*. A partial ban on member-borne commissions had been introduced from that date, but this applied only to new contracts. However, the extended prohibition will not apply to charges imposed to reimburse a service provider for any commission payment incurred under a *pre-April 6, 2016*, contract where the payment is made before *October 1, 2017*, the intended date for the Regulations to come into force.

The consultation closes on *May 31, 2017*.

View the consultation.

Age discriminatory transitional provisions in pension schemes – can they be objectively justified?

In two recent cases, an employment tribunal (ET) has considered discriminatory pension scheme provisions.

In *McCloud and Others v Lord Chancellor and Secretary of State and Another* (McCloud) (on which we reported briefly in February 2017), the ET held that discriminatory transitional provisions in the Judicial Pensions Regulations 2015 (JPR 2015), which mitigated the effect of compulsory pension reforms for older judges, could not be objectively justified and were therefore unlawful.

In *Sargeant and Others v London Fire and Emergency Planning Authority and Others* (Sargeant), the ET held that the transitional provisions for changes to the Firefighters' Pensions Scheme *were* objectively justifiable and therefore *were* not unlawfully discriminatory on grounds of age, race or sex.

Neither decision is binding on a future tribunal, and we understand that both these decisions are likely to be appealed.

Comment

It is difficult to reconcile the McCloud and Sargeant decisions. The respective ETs reached the opposite conclusion on some of the key questions, including whether protecting those over a certain age was even capable of being a legitimate aim, because it was itself age-based. In addition, the ET in McCloud considered there was no rational explanation as to why the judges closest to retirement needed protection, as they were least affected by the changes.

It is understood that the Government has now sought permission to appeal the McCloud decision, citing among other things the ET's decision in Sargeant in support of the appeal. In addition, the Fire Brigades Union has lodged an appeal in Sargeant.

Neither decision is, of course, binding on a future tribunal, but it is surprising that opposite conclusions could have been reached on facts which are so similar. There are also other cases in the tribunal system, including one brought in relation to the police pension scheme, so this is an area that will require watching in future.

Dutton and Others v FDR Limited [2017] – Court of Appeal reverses High Court judgment and finds in favour of employer on calculation of pension increases

The Court of Appeal (CA) has reversed a 2015 decision of the High Court (HC) and has found in favour of the employer in relation to an issue of interpretation of the pension increase provisions applying to pensions in payment.

Summary

In our October 2015 update, we reported on the case of *Dutton and Others v FDR Limited*, in which the HC agreed with the trustees and found in favour of members in the way in which the increase rule was interpreted. As this interpretation would result in an increase of £17 million to the scheme deficit, the employer appealed. The CA handed down its judgment on March 29, 2017, in which it unanimously upheld the employer's appeal.

The case does not strictly relate to general scheme issues relating to switching from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI), but does provide some useful commentary on the interpretation of provisos in powers of amendment under pension scheme rules.

Background

The FDR Limited Pension Scheme (the Scheme) was established in 1972 and originally provided for pensions in payment to be increased by a fixed rate of three per cent per annum. In June 1991, the Scheme's rules were amended by deed to provide instead that pensions in payment should be increased by the lesser of five per cent and RPI, purportedly in respect of past as well as future service.

The Scheme's power of amendment contained a proviso which prevented both pensions in payment and members' accrued rights from being affected prejudicially.

The parties agreed that the 1991 deed of amendment was valid in so far as it operated prospectively. However, where past service was concerned, the 1991 amendment infringed the proviso in the Scheme rules that any amendment should not affect adversely any pension in payment or accrued rights up to the effective date of the amendment.

The employer argued that members' rights in respect of pre-1991 service were protected by an underpin by which pensioners were entitled each year only to increases at the higher of either three per cent fixed and five per cent/RPI calculated cumulatively on their starting pension. This would have resulted in members receiving increases of significantly less than three per cent per annum in respect of their pre-1991 service because of higher increases received by them in past years.

The trustees argued (on behalf of members) that pensioners were entitled to an increase of the better of three per cent fixed and five per cent/RPI. The increase should be applied on an annual basis to pensions in payment attributable to pre-1991 service.

The HC decision

In the HC, Asplin J considered three possible interpretations of the proviso (that any change in the rules must not prejudicially affect any pension in payment or any accrued rights) in the power of amendment, and the way the proviso applied to the changes made to the increase rule under the 1991 deed of amendment

- The trustees' Annual Approach – this required the pre June 20, 1991 element of a pension in any given year to be increased on each anniversary of the commencement of the pension by the greater of (a) three per cent per annum and (b) five per cent Limited Price Indexation (LPI).

- The trustees' Alternative Approach – this required the annual increase to be the higher of (a) the value of the pre June 20, 1991 element of the member's pension as at the date of retirement to be increased year on year by three per cent per annum compound, up to and including the year in which the increase is to take effect; and (b) the value of that element of the member's pension paid in the year immediately prior to the increase taking effect increased by five per cent LPI.

- The employer's Modified Cumulative Approach – this required two separate calculations of a member's entitlement: the first calculating the value of that element of the member's pension retrospectively as from the date of retirement increased year on year by three per cent per annum compound up to and including the year in which the increase is to take effect; the second calculating the value of that element of the member's pension retrospectively as from the date of retirement increased year on year by five per cent LPI compound up to and including the year in which the increase is to take effect, subject to a floor of zero per cent to avoid the effects of any negative retail prices increase. The relevant element of the pension payable in any given year was the higher of the two calculations.

The difference in the parties' positions explained

The CA judgment sets out that the essential difference in the parties' positions is that the trustees' two methods required the pension increase to be calculated annually by applying the appropriate percentage increase to the amount which was in fact paid by way of pension in the previous year. The employer's method required an annual retrospective calculation over the whole of the period during which the pension has been in payment to see which of the old rule and the new rule would produce the higher result.

The CA decision

Asplin J (in the HC) had concluded that the Annual Approach was the most workable and practical, and therefore the one that should apply. The CA disagreed, as the Annual Approach gave a pensioner more than their entitlement under the old rules, and also more than would have the benefit entitlement by virtue of the new rules which were intended to supersede the old rules.

The proviso (in the power of amendment) was simply intended to preserve a pensioner's entitlement under the old rules (which is what the Modified Cumulative Approach achieves); not to provide the best of both worlds.

The CA did not agree with the HC's approach of interpreting the old increase rule and the amended increase rule as a 'blend'. The intention of the trustees and the employer in amending the rule was clear: they wanted to do away with the old rule completely and bring in the new, and the question was the extent to which the proviso frustrated that intention.

The CA found that the purpose of the proviso was to ensure that the pensioner would receive a pension which, in any given year, was not less than the pension which would have been received but for the change in the rules and the Modified Cumulative Approach preserved that right.

Comment

This decision does not relate strictly to schemes' ability to use the CPI or RPI to calculate pension increases, but rather to how this particular scheme increase rule should be interpreted and how the underpin works in relation to it. However, for the scheme in question, the CA decision means that the funding deficit should be reduced by around £17 million.

While the decision is of limited value in moving the debate forward on general scheme issues relating to switching from the RPI to the CPI, it does provide some useful commentary on the interpretation of provisos in powers of amendment under pension scheme rules.

Dalriada Trustees Limited v Mcauley and others [2017] — High court holds that trustees of alleged pension liberation schemes could not rely on exoneration clause

A transcript was published recently of the previously unreported January 2017 High Court decision in *Dalriada Trustees Limited v Mcauley and others* [2017]. The claimant (Dalriada) was the independent and current trustee of two occupational pension schemes and Mr and Mrs Mcauley (the Defendants) were the former trustees of both those schemes.

Dalriada made applications for summary judgment and a freezing order on the basis that the two schemes had allegedly been engaged in pensions liberation.

Dalriada's application for summary judgment was granted in part, with a freezing order made in respect of the full claim. Regarding a previous freezing order, the Defendants had paid the sum sought, and so it was treated as discharged.

Among other points, the High Court considered whether the Defendants could rely on exoneration or exclusion provisions in the scheme rules. The Defendants accepted that as they had failed to obtain written advice from an appropriately qualified or regulated person before making certain investments, as legally required, they had no defence to Dalriada's argument that they had breached their statutory duties in this regard.

The Court held that section 33 of the Pensions Act 1995 applied to prevent an exclusion or exoneration from liability in respect of an obligation under any rule of law to take care or exercise skill when making investments. It followed that the Defendants could not rely on such clauses in the scheme rules as a defence.

Background

Many pension liberation schemes are set up ostensibly as occupational pension schemes registered with HMRC and, at first sight, do not appear to fall foul of the law. However, they often breach HMRC tax rules regarding unauthorised payments or loans, resulting in adverse tax consequences for the member.

When making investment decisions in respect of a scheme's assets, trustees must exercise their investment powers in accordance with the terms of the scheme's trust deed and rules and the regulations which specify the trustees' criteria for choosing investments and ensuring their diversification.

Section 36 of the Pensions Act 1995 (PA 1995) provides that, before making any investment, trustees must obtain and consider 'proper advice'. Usually, the provision of the advice itself constitutes a regulated activity under the Financial Services and Markets Act 2000 (FSMA). The trustees must obtain the advice from an appropriate person who is FSMA-authorised, it must be in writing (or subsequently confirmed in writing, if given orally).

Generally, trustees can include provisions in their trust deeds excluding or restricting liability for their acts or omissions but they cannot exclude or restrict liability for breach of their duty to act with reasonable skill and care in the performance of any investment functions (section 33 of the PA 1995).

Facts

The applications in this case related to two sets of proceedings in respect of two occupational pension schemes with common trustees – a husband and wife. Both former trustees had been removed by the court on the application of TPR, and a professional trustee (Dalriada) had been appointed. A freezing order had subsequently been granted in February 2014 in respect of one of the schemes.

Dalriada alleged that the Defendants had engaged in pension liberation and sought a freezing order and summary judgment in respect of one of the schemes, as well as an extension to the existing freezing order in respect of the other scheme.

Dalriada alleged that

- Payments had been made from one of the schemes to two companies that were not proper payments or investments of funds. The Defendants contended that these payments were in fact loans entered into on the basis of advice. Following the earlier freezing order, payments had been made to Dalriada in the amount of the loans plus interest.

- A £3.275 million 'premium' had been paid from the assets of the other scheme as part of three 'gilt option agreements' entered into between the Defendants and a third party company. These agreements operated to grant the Defendants the option to have government gilts transferred to them in an amount equal to, broadly, the proceeds of exploiting certain patents.

- A consultancy agreement was entered into whereby only 15 per cent of the funds invested in the 'agreements' were to be paid to the company holding the patents, the balance being paid to a different entities including one of the parties to the loans mentioned above.

Dalriada claimed that

- The premium payment was made in breach of trust by the Defendants for the improper purpose of releasing benefits to members early.

- The Defendants were in breach of their equitable duty of care to exercise their powers as an ordinary prudent man of business. The agreements were either not truly an investment at all, or, if they were, they were investments which no reasonable trustee could make, and made without the benefit of relevant advice.

- The Defendants were in breach of their statutory duties under section 36 of the PA 1995 by not taking proper advice in writing.

As well as freezing orders in respect of the loans and the agreements, the claimants sought summary judgment in respect of the £3.275 million investment in the agreements, based on the claims of breach of the equitable duty of skill and care and the statutory duty under section 36.

Decision

In respect of the agreements, the judge (Mr R. Miles QC) granted the application for both summary judgment and the freezing order.

The Defendants had accepted that because they had failed to obtain written advice from an appropriately qualified or regulated person as required by section 36 they had no defence to that claim, and accepted that summary judgment should be entered against them. The judge held that there was 'no realistic defence', either to the claim for breach of the equitable duty or for breach of section 36 and that it was: "clear beyond any reasonable argument that the payments of £3.275 million were not investments that a trustee exercising proper skill and care could make".

Although the Defendants had claimed that they had relied on advice, and that some due diligence had been done, the judge considered that "... there was no reasonable prospect that an adviser would have advised them to enter into an investment of this kind".

The Court held that section 33 of the PA 1995 applied to prevent an exclusion or exoneration from liability in respect of an obligation under any rule of law to take care or exercise skill when making investments. It followed that the Defendants could not rely on such clauses in the scheme rules as a defence.

On the basis that just over half of the invested amount had been repaid to scheme members, the judge granted summary judgment in respect of the outstanding sum, with interest to be applied. However, he confirmed that there would subsequently be a final judgment for this amount, as well as in respect of any further liability of the Defendants.

Granting the freezing order in respect of the full amount of the premium, the judge stated that, even if the Defendants were not guilty of dishonesty, they showed a 'casual disregard on their part for ordinary standards of commercial propriety'.

As regards the freezing order granted in 2014 in respect of the loans, the judge confirmed that it had ceased to have effect as the sum specified in that order had been secured in full. He rejected Dalriada's submission that the order should remain in place for a lesser sum representing their costs.

Comment

This case is another example of an alleged pension liberation scheme gone wrong. Again, the sums involved are substantial, with the members suffering from a number of potentially unauthorised payments and tax charges.

The judgment is also interesting as there have been relatively few cases considering the application of section 36 and trustees' investment decision-making. The case is a good example of a clear breach of this duty, and was recognised as such by the Defendants, who conceded their position on this in Court.

The case also serves as an example of how failure to comply with the trustees' duties on investment can result in them being unable to rely on any exoneration provisions of the scheme's trust deed.

Baugniet v Capita Employee Benefits Ltd (t/a teachers' pensions) and another [2017] – High Court suggests Pensions Ombudsman reconsiders £1,000 limit for non-financial loss

The High Court has urged the Pensions Ombudsman (PO) to reconsider the appropriate award of compensation for non-financial loss and to rebase the upper limit at £1,600 for unexceptional cases.

The member concerned had requested an estimate of the service credit in the Teachers' Pension Scheme in respect of a transfer of his personal pension rights. Initial calculations provided by the scheme administrators were incorrect. A revised estimate was later provided, but before it was accepted by the member the Government Actuaries Department imposed an embargo on transfers pending the calculation of new transfer factors. This resulted in a delay, further compounded by additional delay in confirming the amount of the transfer with the personal pension provider. As a result, the revised estimated service credit was significantly lower than the original estimate provided.

The PO dismissed the complaint but awarded £750 for non-financial injustice. The member appealed to the High Court who remitted the matter back to the PO for redetermination.

The judge also directed the PO to reconsider the appropriate award of compensation for non-financial loss. Commenting that the upper limit of £1,000 for maladministration falling short of exceptional was 'out of touch with the value of money', he urged the PO to rebase the upper limit at £1,600 (the present sterling equivalent of £1,000 in 1998) noting that the £1,000 figure was determined by the court almost two decades ago.

Comment

It is unsurprising that the judge considered the upper limit of £1,000 to be 'out of touch'. The unfortunate administrative delays resulted in a significantly reduced service credit for the member who had to wait five years before the correct service credit calculation was provided. The PO's own 2015 guidance recognised a shift in attitudes towards making higher awards and commented that this may be necessary where ill-health or lifestyle choices are affected. Nevertheless, it stated that the starting point for compensation is £500 and that most awards fell in the £500 to £1,000 range.

The case also serves as a reminder that a scheme's internal dispute resolution process (IDRP) must involve objective review. The judge called the approach of the second stage decision-maker under the IDRP into question commenting that the fact that the member's service credit was not accurately calculated until after the PO's determination appeared to indicate that they had not independently reviewed or checked the accuracy of the scheme administrator's assertions and calculations.

Schemes should bear this in mind when considering complaints under their IDRP.

Mrs Y (PO-15209): Pension sharing on divorce – no duty to inform pensioner member of changes to normal pension age or transfer calculation factors

In a decision published on *March 22, 2017*, the Pensions Ombudsman (PO) found that the trustees were not required to inform a pensioner member of changes to the scheme's normal pension age (NPA), rejecting arguments that the scheme should have continued to inform retired members of any such changes since it might be relevant to couples who were divorcing.

The PO also found that the scheme was not required to inform members of a change to the calculation basis for transfers.

The complainant, who had taken an internal transfer following her divorce from a retired member of the scheme, complained that she had entered into the divorce on the basis of misleading scheme information that she could take an unreduced pension at age 63 ½, when the NPA was in fact 65. She also argued that she would not have proceeded with the divorce had she been aware that the factors used for calculating transfers had changed since the initial transfer value quotation was provided, resulting in a lower annual pension based on her share of her former husband's pension than she had expected.

The PO disagreed with the complainant and found that information about the scheme's NPA was readily available on the scheme's website and had been included with the initial transfer value quotation. In addition, the member had been informed in an initial valuation that the total pension amount could change since it would be recalculated once the divorce absolute had been issued. The member had not, therefore, been misinformed about the overall pension value or the scheme's NPA.

The PO commented further that trustees had a fiduciary duty to ensure that the scheme was being managed in accordance with the rules, which included ensuring that the factors used for calculating transfers were suitable.

Comment

There can be problems encountered relating to how a pension sharing order (PSO) is implemented, as the PSO takes effect when the decree absolute is granted, but the member's transfer value for the purposes of the benefits transferred to the ex-spouse is recalculated at a later date falling within the statutory four month implementation period. It is therefore difficult to protect against a situation where changes to the way in which transfer values are calculated are made before a PSO is implemented.

Perhaps the member's expectations could have been better managed if an updated valuation been obtained and communicated before the divorce was finalised, but often trustees are working within quite strict cost and time limits for the implementation of a PSO.

The PO's conclusion that the trustees were not obliged to inform members about future changes to the transfer basis highlights the wide discretion trustees have in setting the basis underlying the CETV calculations.

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